

Montgomery County Employee Retirement Plans

Comprehensive Annual Financial Report



Employees' Retirement System Retirement Savings Plan Deferred Compensation Plan (Trust Funds of Montgomery County, Maryland)

Fiscal Year 2002
July 1, 2001 – June 30, 2002

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Fiscal Year 2002
July 1, 2001 – June 30, 2002

Prepared by the Board of Investment Trustees
11 North Washington Street, Suite 250
Rockville, Maryland 20850

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Certificate of Achievement for Excellence in Financial Reporting

Presented to

Montgomery County
Employee Retirement Plans,
Maryland

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2001

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



Imelda Arave
President

Jeffrey L. Esser
Executive Director

INTRODUCTION SECTION



OFFICES OF THE COUNTY EXECUTIVE

Douglas M. Duncan
County Executive

Bruce Romer
Chief Administrative Officer

January 24, 2003

Honorable County Executive and
Members of the Montgomery County Council

I am pleased to present to you the Comprehensive Annual Financial Report of the Montgomery County, Maryland Employee Retirement Plans ("Plans") for the fiscal year ended June 30, 2002. This annual report is designed to assist you in understanding the structure and current status of the Plans.

This report was prepared pursuant to the provisions of Section 33-51(b) of the Montgomery County Code of 1994, as amended, and includes the independent auditors' report, issued by the County Council's appointed independent public accounting firm. Responsibility for the accuracy of the presented data and the completeness and fairness of the presentation including all disclosures rests with Montgomery County, Maryland. We believe the data, as presented, is accurate in all material aspects; that it is presented in a manner designed to fairly set forth the plan net assets and the changes in plan net assets and financial position of the Plans; and that all disclosures necessary to enable the reader to gain the maximum understanding of the financial affairs of the Plans have been included.

The accompanying report consists of five sections: an **Introduction Section** which contains the Certificate of Achievement, this transmittal letter, and the organization structure; a **Financial Section** which contains the report of the independent auditors, the management's discussion and analysis, the financial statements of the Plans and required supplementary information; an **Investment Section** which contains investment results for the Employees' Retirement System ("System") defined benefit pension plan; an **Actuarial Section** which contains the independent actuary's certification letter, a summary of the results of the actuarial valuation, including actuarial procedures and assumptions for the System; and a **Statistical Section** which contains information on the System's membership.

History

The Employees' Retirement System was established in 1965, as a cost-sharing multiple-employer defined benefit pension plan providing benefits to the employees of Montgomery County and other agencies or political subdivisions who elect to participate. Participating agencies and subdivisions include the: Montgomery County Revenue Authority, Housing Opportunities Commission of Montgomery County, independent fire/rescue corporations, Town of Chevy Chase, Strathmore Hall Foundation, Inc., Washington Suburban Transit Commission, and certain employees of the State Department of Assessments and Taxation and the District Court of Maryland. The System is closed to employees hired on or after October 1, 1994, except public safety bargaining unit employees. There were 5,989 active members and 4,115 retirees participating in the System as of June 30, 2002.

The Retirement Savings Plan was established in 1994, as a cost-sharing multiple-employer defined contribution plan providing benefits to all non-public safety and certain public safety employees hired on or after October 1, 1994. Employees covered by the Employees' Retirement System may make an irrevocable decision to transfer to this Plan. At June 30, 2002, there were 2,908 active plan members.

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The Deferred Compensation Plan was established pursuant to Section 457 of the Internal Revenue Code, as amended. During Fiscal Year ("FY") 1999, in accordance with Federal legislation, the assets of the Plan were placed in trust for the sole benefit of participants and their beneficiaries.

Benefit Provisions

The benefit provisions of the Employees' Retirement System are established by Montgomery County Code. The System provides for normal service retirement and early service retirement benefits for members who attain age and service requirements. The System also provides options for disability and death benefits to eligible participants. Members are vested after five years of service.

The Retirement Savings Plan provides for immediate vesting of employee contributions and employer contributions are vested after three years of service or upon death, disability or retirement age.

Major Initiatives

Change in accounting policy - Effective July 1, 2001, the Board implemented Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, and Statement No. 37, *Basic Financial Statements - Management's Discussion and Analysis - for State and Local Governments: Omnibus*. The two primary impacts of the implementation of these statements are the addition of a Management's Discussion and Analysis (MD&A) section and a change in presentation for the Deferred Compensation Fund. The MD&A provides information that will allow users to assess whether the Employee Retirement Plans' financial position has improved or deteriorated as a result of the year's operations. The Deferred Compensation Plan was previously presented as an expendable trust fund utilizing modified accrual accounting, and is now presented as a pension trust fund utilizing full accrual accounting.

During FY 2002, the Board amended its asset allocation strategy to include allocations to Treasury Inflation Protection Securities and Alternative Investments.

In addition, the Board continued its strategic review of operations by completing the transfer of participant communication functions from the Board Staff Office to the Office of Human Resources.

Financial Information

Accounting System and Reports

The Plans' financial statements have been prepared under the accrual basis of accounting. Contributions are recognized in the period in which the contributions are due. Benefits and refunds are recognized when due in accordance with the terms of the Plans.

Management's Discussion and Analysis

The Management's Discussion and Analysis (MD&A), which can be found on pages 12 to 17 of this report, provides a brief analysis of the financial performance of the Plans and an introduction to the financial statements of the Plans for the year ended June 30, 2002.

Investments

Montgomery County has established a Board of Investment Trustees to be responsible for the investment management of the Plans' assets for the exclusive benefit of the members and participants. The Board consists of nine members appointed by the County Executive.

INTRODUCTION SECTION

In overseeing the management of the assets of the Plans, the Board has developed sound and prudent investment policies. For the Employees' Retirement System, an appropriate balance must be struck between risks taken and returns sought to ensure the long term health of the defined benefit plan. The Board has adopted an investment policy that works to control the extent of downside risk to which the System is exposed while maximizing the potential for long term increases in the value of assets. To achieve this objective, System assets are allocated to a broad array of investment sectors as follows: domestic equities 50%, international equities 15%, domestic fixed income 30% and Treasury Inflation Protection Securities 5%. For the twelve months ended June 30, 2002, the total return achieved by the System's investments was a loss of 6.7 percent, compared to the System's actuarial target of 8 percent.

Section 33-125 of the Montgomery County Code authorizes the Board to establish, for members of the Retirement Savings Plan, a diversified slate of mutual and commingled investment funds from which participants may select options. The Board has developed a statement of policies and objectives outlining its oversight of the investment products offered.

The Board has established a diversified slate of mutual and commingled funds for the Deferred Compensation Plan which offer a range of options from which participants may select. The Board has constructed an investment policy stipulating investment objectives and oversight by the Board.

Funding

The System's actuary uses a five-year smoothed market related-value to determine the actuarial value of assets. The smoothing prevents extreme volatility in employer contribution rates due to short-term fluctuations in the investment markets. For the June 30, 2002 valuation, the actuarial value of assets was \$2.0 billion. The aggregate actuarial liability was \$2.3 billion. The Schedule of Funding Progress found in the Required Supplementary Information of the Financial Section, expresses System net assets as a percentage of the actuarial accrued liability, providing one indication of the System's funding status on a going-concern basis. The actuary has determined that the present net asset base, expected future contributions and investment earnings thereon, are sufficient to provide for full payment of future benefits under the projected unit credit actuarial cost method.

Internal Control Structure and Budgetary Controls

The Plans' management is responsible for maintaining internal accounting controls to provide reasonable assurance that transactions are properly authorized and recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America. We believe the internal controls in effect during the fiscal year ended June 30, 2002, adequately safeguard the Plans' assets and provide reasonable assurance regarding the proper recording of financial transactions. In addition, the Board of Investment Trustees approves and actively monitors the annual budget for each plan.

Independent Audit and Actuarial Certification

An independent auditors' report and certification from the actuary are included in this report.

Certificate of Achievement for Excellence in Financial Reporting

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the Montgomery County Employee Retirement Plans for its comprehensive annual financial report for the fiscal year ended June 30, 2001. The Certificate of Achievement is a prestigious national award, recognizing conformance with the highest standards for preparation of state and local government financial reports. In order to be awarded a Certificate of Achievement, a government unit must publish

INTRODUCTION SECTION

an easily readable and efficiently organized comprehensive financial report, whose contents conform to program standards. Such a report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. The Montgomery County Employee Retirement Plans have received the Certificate of Achievement for the last two consecutive years. We believe our current report continues to conform to the Certificate of Achievement program requirements and we are submitting it to the GFOA.

Acknowledgements

The Comprehensive Annual Financial Report of the Montgomery County Employee Retirement Plans was prepared by the Board of Investment Trustees staff in conjunction with staff support from the County's Department of Finance and Office of Human Resources. I would like to express my appreciation to the employees that have worked hard throughout the year to ensure the successful operation of the Plans.

Respectfully submitted,

Bruce Romer
Chief Administrative Officer

INTRODUCTION SECTION

BOARD OF INVESTMENT TRUSTEES

Stephen B. Farber

Chair
Montgomery County Council Staff Director
Ex-Officio Member

Arthur W. Spengler

Vice Chair
Retired Employees Representative
Term Expires March 2003

Sandra P. Kaiser

Secretary
Montgomery County
Department of Permitting Services
Non-Bargaining Unit Representative
Term Expires March 2005

Mark A. Barnard

Montgomery County Council Representative
Term Expires March 2003

Sharon M. Cayelli

Citizen Representative
Term Expires March 2005

Timothy L. Firestine

Montgomery County Director of Finance
Ex-Officio Member

Vacant

Montgomery County Director
of Human Resources
Ex-Officio Member

John J. Sparks

Montgomery County
Career Fire Fighters Assn
Bargaining Unit Representative
Term Expires March 2004

Robert K. Kendal

Montgomery County Director of
Management and Budget
Ex-Officio Member

INTRODUCTION SECTION

ADMINISTRATIVE ORGANIZATION

Administrative Staff

James E. Torgesen
Acting Director - Office of
Human Resources

Timothy L. Firestine
Director of Finance

Linda A. Herman
Acting Director -
Pension Investments

Professional Services

Actuary

William M. Mercer, Inc.
Actuaries
Washington, DC

Investment Consultant

Wilshire Associates
Santa Monica, CA

Auditor

KPMG LLP
Certified Public Accountants
Washington, DC

Investment Managers-Employees' Retirement System

Capital Guardian Trust Company
Los Angeles, CA

William Blair & Company
Chicago, IL

Lazard Asset Management
New York, NY

Numeric Investors
Cambridge, MA

RhumbLine Advisers
Boston, MA

Fidelity Investments
Hebron, KY

Systematic Financial Management
Teaneck, NJ

WR Huff Asset Management Co.
Morristown, NJ

BlackRock Financial Management, Inc.
New York, NY

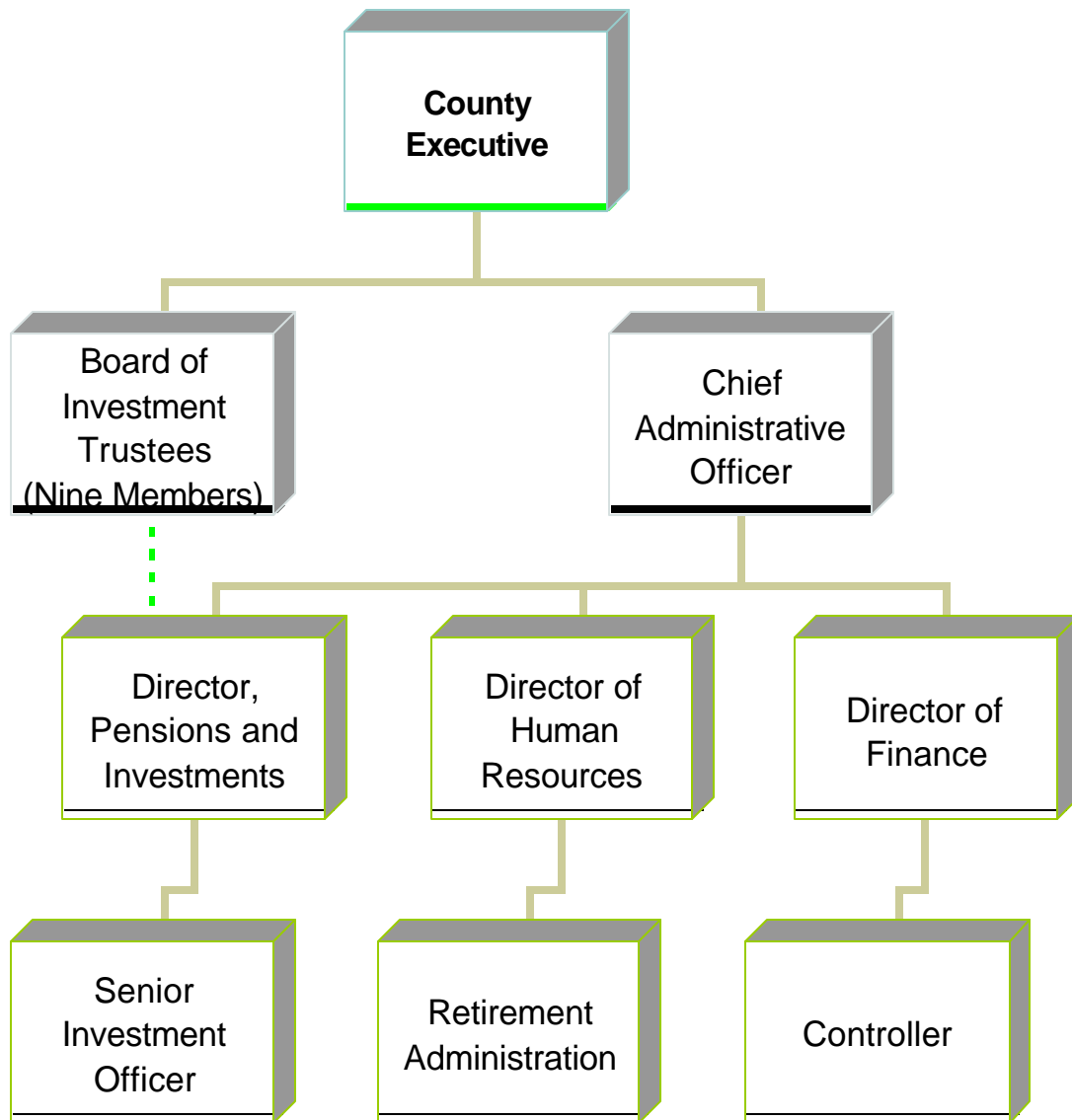
Barclays Global Investments
San Francisco, CA

JP Morgan Investment Management
New York, NY

Custodial Bank-Employees' Retirement System

The Northern Trust Company
Chicago, IL

Organization Chart



FINANCIAL SECTION



2001 M Street, N.W.
Washington, D.C. 20036

Independent Auditors' Report

The County Council of Montgomery County, Maryland:
The Board of Trustees

Montgomery County Employees' Retirement Plans:

We have audited the accompanying statements of plan net assets of the Montgomery County Employees' Retirement Plans (the Plans) as of June 30, 2002 and the related statements of changes in plan net assets for the year then ended. These financial statements are the responsibility of the Plans' management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the plan net assets of the Plans as of June 30, 2002 and the changes in their plan net assets for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in the significant accounting policies of the notes to the financial statements, the Plans implemented Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, and Statement No. 37, *Basic Financial Statements – and Management Discussion and Analysis – for State and Local Governments: Omnibus*, effective July 1, 2001.

The management's discussion and analysis on pages 12 through 17 and the schedule of funding progress and notes thereto, on pages 28 and 29, are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the 2002 basic financial statements taken as a whole. The 2002 supplementary information on pages 30 through 37 is presented for purposes of additional analysis and is not a required part of the 2002 basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the 2002 basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the 2002 basic financial statements taken



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as whole. The information included in the introduction, investment, actuarial, and statistical sections has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on such information.

We have also previously audited, in accordance with auditing standards generally accepted in the United States of America, the statements of plan net assets of the Plans as of June 30, 2001, and the related statements of changes in plan net assets for the year then ended (none of which is presented herein), and we expressed an unqualified opinion on those financial statements. The supplementary information included on pages 32 through 37 related to the Plans' 2001 financial statements was subjected to auditing procedures applied in the audit of those basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements from which it has been derived.

KPMG LLP

January 17, 2003

FINANCIAL SECTION

MANAGEMENT'S DISCUSSION AND ANALYSIS

Year Ended June 30, 2002

Introduction

The following Management's Discussion and Analysis (MD&A) of the Montgomery County Employee Retirement Plans ("Plans") financial performance provides an introduction to the financial statements of Plans as of and for the year ended June 30, 2002. Since the MD&A is designed to focus on current activities, resulting changes and current known facts, please read it in conjunction with the transmittal letter in the Introduction Section on page 3, the financial statements, required supplementary information, and supplementary information which follow this discussion.

Required Financial Statements

The financial statements for the Plans have been prepared under the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America, promulgated by the Governmental Accounting Standards Board. The Statements of Plan Net Assets comprise the Plans' assets and liabilities and provide information about the nature and amount of investments, as well as the liabilities distinguished by long-term and other liabilities. The Statements of Changes in Plan Net Assets measure the changes of the Plans' net assets, measured by the additions by major sources and deductions by type. Comparative financial statements of the three plans are presented in the latter part of the financial section.

Financial Analysis of the Montgomery County Employee Retirement Plans

Shown below is a condensed presentation of the Net Assets of the Employees' Retirement System ("ERS"), Retirement Savings Plan ("RSP"), and Deferred Compensation Plan ("DCP") at June 30:

	Net Assets (Millions)					
	ERS		RSP		DCP	
	2002	2001	2002	2001	2002	2001
Assets						
Cash & investments	\$1,896.2	\$1,867.8	\$28.4	\$23.6	\$184.2	\$199.6
Receivables	8.9	12.0	0.4	0.4	0.8	0.7
Total Assets	1,905.1	1,879.8	28.8	24.0	185.0	200.3
Total Liabilities	227.6	42.1	0.0	0.1	0	0
Total Net Assets	<u>\$1,677.5</u>	<u>\$1,837.7</u>	<u>\$28.8</u>	<u>\$23.9</u>	<u>\$185.0</u>	<u>\$200.3</u>

FINANCIAL SECTION

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONT'D)

Shown below is a condensed summary of the Change in Net Assets of all Plans for the years ended June 30:

	Change in Net Assets (Millions)					
	ERS		RSP		DCP	
	2002	2001	2002	2001	2002	2001
Additions						
Employer contributions	\$39.2	\$43.3	\$5.8	\$4.9	\$20.1	\$18.7
Member contributions	12.9	11.3	3.3	2.6	0	0
Net investment loss	(124.2)	(81.3)	(3.2)	(2.4)	(25.5)	(27.7)
Total Additions	<u>(72.1)</u>	<u>(26.7)</u>	<u>5.9</u>	<u>5.1</u>	<u>(5.4)</u>	<u>(9.0)</u>
Deductions						
Benefits	85.3	78.4	0	0	0	0
Refunds	0.7	1.1	0.9	1.5	9.9	4.8
Administrative expenses	2.1	1.7	0.1	0.1	0.1	0.1
Total Deductions	<u>88.1</u>	<u>81.2</u>	<u>1.0</u>	<u>1.6</u>	<u>10.0</u>	<u>4.9</u>
Total Change in Net Assets	<u><u>\$(160.2)</u></u>	<u><u>\$(107.9)</u></u>	<u><u>\$4.9</u></u>	<u><u>\$3.5</u></u>	<u><u>\$(15.4)</u></u>	<u><u>\$(13.9)</u></u>

The following schedules provide a comparative summary and an analysis of each Plans' assets, liabilities and net assets, at June 30:

	Employees' Retirement System Net Assets (Millions)		
	2002	2001	Percentage Change
Assets			
Cash & investments	\$1,896.2	\$1,867.8	1.5%
Receivables	<u>8.9</u>	<u>12.0</u>	(25.8)%
Total Assets	<u>1,905.1</u>	<u>1,879.8</u>	1.4%
Liabilities			
Benefits payable and other liabilities	2.1	2.6	(19.2)%
Obligations under securities lending agreements	<u>225.5</u>	<u>39.5</u>	470.9%
Total Liabilities	<u>227.6</u>	<u>42.1</u>	440.6%
Total Plan Net Assets	<u><u>\$1,677.5</u></u>	<u><u>\$1,837.7</u></u>	(8.7)%

The table shown above reflects the System's net assets decreased by \$160.2 million during FY 2002. The decrease reflects adverse market conditions incurred during the last twelve months and reduced investment earnings. During the previous fiscal year, net assets decreased by \$107.8 million.

FINANCIAL SECTION

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONT'D)

Retirement Savings Plan

Net Assets (Millions)

	<u>2002</u>	<u>2001</u>	<u>Percentage Change</u>
Assets			
Cash & investments	\$28.4	\$23.6	20.3%
Receivables	<u>0.4</u>	<u>0.4</u>	0%
Total Assets	<u>28.8</u>	<u>24.0</u>	20.0%
Total Liabilities	<u>0.0</u>	<u>0.1</u>	(100.0)%
Total Plan Net Assets	<u>\$28.8</u>	<u>\$23.9</u>	20.5%

During FY 2002, net assets increased from \$23.9 million in 2001 to \$28.8 million in 2002. The increase is attributable to a decrease in the number of refunds, or members leaving the Retirement Savings Plan, and an increase in contributions. Membership in the Retirement Savings Plan rose from 2,536 at June 30, 2001 to 2,908 at June 30, 2002.

Deferred Compensation Plan

Net Assets (Millions)

	<u>2002</u>	<u>2001</u>	<u>Percentage Change</u>
Assets			
Investments	\$184.2	\$199.6	(7.7)%
Receivables	<u>0.8</u>	<u>0.7</u>	14.3%
Total Assets and Plan Net Assets	<u>\$185.0</u>	<u>\$200.3</u>	(7.6)%

Net assets for the Deferred Compensation Plan decreased from \$200.3 million at June 30, 2001 to \$185 million at June 30, 2002. The decrease is attributable to an increase in the number of refunds paid or withdrawals during FY 2002 and current market conditions.

**MANAGEMENT'S DISCUSSION AND ANALYSIS
(CONT'D)****Additions**

The primary sources of additions for the Plans include member and employer (where applicable) contributions and investment income. The following tables show the source and amount of additions for each Plan during FY 2002 and FY 2001.

**Employees' Retirement System
Contributions and Investment Income
(Millions)**

	<u>2002</u>	<u>2001</u>	<u>Percentage Change</u>
Employer contributions	\$ 39.2	\$ 43.3	(9.5)%
Member contributions	12.9	11.3	14.2%
Net investment loss	<u>(124.2)</u>	<u>(81.3)</u>	(52.8)%
	<u>\$(72.1)</u>	<u>\$(26.7)</u>	(170.0)%

During FY 2002, employer contributions to the Employees' Retirement System decreased by 9.5 percent due to investment gains in recent years which equaled or exceeded the System's actuarial assumed investment return rate. Member contributions increased by 14.2 percent due mainly to higher pay levels.

The net investment loss for the Employees' Retirement System totaled \$124.2 million for FY 2002, comprised of \$168.3 million in net depreciation in fair value of investments, \$49.7 million in dividends and interest, \$3.4 million from securities lending activities, and \$9.0 million related to investment expenses. This is compared to net investment loss of \$81.3 million in FY 2001.

**Retirement Savings Plan
Contributions and Investment Income
(Millions)**

	<u>2002</u>	<u>2001</u>	<u>Percentage Change</u>
Employer contributions	\$ 5.8	\$ 4.9	18.4%
Member contributions	3.3	2.6	26.9%
Net investment loss	<u>(3.2)</u>	<u>(2.4)</u>	(33.3)%
	<u>\$ 5.9</u>	<u>\$5.1</u>	15.7%

Employer contributions to the Retirement Savings Plan were \$5.8 million in FY 2002, an increase of 18.4 percent from FY 2001. Member contributions were \$3.3 million in FY 2002, an increase of 26.9 percent from FY 2001. The increase in contributions reflects the increase in the number of participants during FY 2002.

Depreciation in investments and reduced income levels reflect the current market conditions.

FINANCIAL SECTION

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONT'D)

Deferred Compensation Plan Contributions and Investment Income (Millions)

	<u>2002</u>	<u>2001</u>	<u>Percentage Change</u>
Member contributions	\$20.1	\$18.7	7.5%
Net investment loss	<u>(25.5)</u>	<u>(27.7)</u>	7.9%
	\$ (5.4)	\$ (9.0)	40.0%

The Deferred Compensation Plan recorded contributions of \$20.1 million for FY 2002 compared to \$18.7 million for FY 2001. Participation levels have increased in recent years due to employee awareness of the Plan and its benefits.

Net investment loss for the Deferred Compensation Plan was \$25.5 million, compared to the investment loss of \$27.7 million in the previous fiscal year, which was primarily due to market conditions and a decrease in investment earnings.

Deductions

The primary sources of deductions from the Plans include the payment of retiree and survivor benefits, participant refunds, and administrative expenses. The following tables show the use and amount of deductions for each plan during FY 2002 and 2001.

Employees' Retirement System Deductions by Type (Millions)

	<u>2002</u>	<u>2001</u>	<u>Percentage Change</u>
Benefits	\$85.3	\$78.4	8.8%
Refunds	0.7	1.1	(36.4)%
Administrative expenses	<u>2.1</u>	<u>1.7</u>	23.5%
	\$88.1	\$81.2	8.5%

During FY 2002 benefit payments increased by 8.8% over FY 2001 due primarily to an increase in the number of retirees. Refunds paid decreased by 36.4% from FY 2001 levels. Administrative expenses increased from \$1.7 million in FY 2001 to \$2.1 million in FY 2002 due to programming enhancements to the computer system and rent expense.

**MANAGEMENT'S DISCUSSION AND ANALYSIS
(CONT'D)****Retirement Savings Plan
Deductions by Type
(Millions)**

	<u>2002</u>	<u>2001</u>	<u>Percentage Change</u>
Refunds and administrative expenses	\$1.0	\$1.6	(37.5)%

The expenditures related to the Retirement Savings Plan are comprised of refunds and administrative expenses. Expenditures for FY 2002 totaled \$1.0 million, a decrease of 37.5 percent over FY 2001 levels due primarily to a decrease in the number of refunds.

**Deferred Compensation Plan
Deductions by Type
(Millions)**

	<u>2002</u>	<u>2001</u>	<u>Percentage Change</u>
Refunds and administrative expenses	\$9.9	\$4.8	106.3%

During FY 2002, refunds distributed from the Deferred Compensation Plan increased 106.3% over the FY 2001 level due to changes in Internal Revenue Code regulations related to the rollover of contributions and investment earnings.

FINANCIAL SECTION

STATEMENTS OF PLAN NET ASSETS

June 30, 2002

	<u>Employees' Retirement System</u>	<u>Retirement Savings Plan</u>	<u>Deferred Compensation Plan</u>
Assets			
Equity in County's pooled cash and Investments	<u>\$552,876</u>	<u>\$1,851,609</u>	\$ _____ -
Investments			
U.S. Government and agency obligations	177,357,723	-	-
Asset-backed securities	19,125,586	-	-
Municipal bonds	492,362	-	-
Corporate bonds	185,437,948	-	-
Common and preferred stock	788,615,229	-	-
Mutual and commingled funds	444,043,247	26,502,116	184,150,051
Short-term investments	45,970,757	-	-
Cash collateral received under securities lending agreements	225,451,924	-	-
Real estate holdings	<u>9,206,461</u>	_____ -	_____ -
Total investments	<u>1,895,701,237</u>	<u>26,502,116</u>	<u>184,150,051</u>
Dividends receivable and accrued interest	6,717,506	-	-
Contributions receivable	2,142,910	466,240	840,009
Capital assets, at cost:			
Office equipment	111,375	-	-
Less: accumulated depreciation	<u>111,375</u>	_____ -	_____ -
Net capital assets	_____ -	_____ -	_____ -
Total assets	<u>1,905,114,529</u>	<u>28,819,965</u>	<u>184,990,060</u>
Liabilities			
Payable for collateral received under securities lending agreements	225,451,924	-	-
Benefits payable and other liabilities	<u>2,142,487</u>	<u>44,061</u>	_____ -
Total liabilities	<u>227,594,411</u>	<u>44,061</u>	_____ -
Net assets held in trust for employee benefits	<u>\$1,677,520,118</u>	<u>\$28,775,904</u>	<u>\$184,990,060</u>

(A schedule of funding progress for the Employees' Retirement System is presented on page 28.)

See accompanying notes to financial statements.

FINANCIAL SECTION

STATEMENTS OF CHANGES IN PLAN NET ASSETS

Year Ended June 30, 2002

	<u>Employees' Retirement System</u>	<u>Retirement Savings Plan</u>	<u>Deferred Compensation Plan</u>
Additions			
Contributions			
Employer	\$39,168,622	\$5,791,248	\$ -
Members	<u>12,943,679</u>	<u>3,307,782</u>	<u>20,085,620</u>
Total contributions	<u>52,112,301</u>	<u>9,099,030</u>	<u>20,085,620</u>
Investment loss	(115,130,901)	(2,985,712)	(25,496,678)
Less investment expenses	<u>9,046,556</u>	<u>214,211</u>	<u>-</u>
Net investment loss	<u>(124,177,457)</u>	<u>(3,199,923)</u>	<u>(25,496,678)</u>
Total additions (reductions)	<u>(72,065,156)</u>	<u>5,899,107</u>	<u>(5,411,058)</u>
Deductions			
Retiree benefits	64,030,235	-	-
Disability benefits	17,250,631	-	-
Survivor benefits	4,041,521	-	-
Refunds	681,375	944,749	9,898,079
Administrative expenses	<u>2,092,364</u>	<u>87,514</u>	<u>48,667</u>
Total deductions	<u>88,096,126</u>	<u>1,032,263</u>	<u>9,946,746</u>
Net increase (decrease)	<u>(160,161,282)</u>	<u>4,866,844</u>	<u>(15,357,804)</u>
Net assets held in trust for pension benefits			
Beginning of year	<u>1,837,681,400</u>	<u>23,909,060</u>	<u>200,347,864</u>
End of year	<u>\$1,677,520,118</u>	<u>\$28,775,904</u>	<u>\$184,990,060</u>

See accompanying notes to financial statements.

FINANCIAL SECTION

NOTES TO THE FINANCIAL STATEMENTS

Year Ended June 30, 2002

INTRODUCTION

The Montgomery County Employee Retirement Plans (Plans) are offered to Montgomery County employees whose eligibility to participate is based on employment status and other factors. Each of the Plans described below were established under a separate section of the Montgomery County code. The accompanying notes summarize the significant accounting policies and plan provisions for each of the plans, including the Employees' Retirement System (System), a defined benefit pension plan; the Retirement Savings Plan, a defined contribution plan; and the Deferred Compensation Plan, a plan established pursuant to Section 457 of the Internal Revenue Code.

EMPLOYEES' RETIREMENT SYSTEM - Defined Benefit Pension Plan

The Montgomery County Employees' Retirement System ("System" or "Plan") is considered part of the County of Montgomery, Maryland's ("County") financial reporting entity and is included in the County's general purpose financial statements as a pension trust fund. The accompanying financial statements present only the operations of the System in conformity with accounting principles generally accepted in the United States of America (GAAP) applicable to public employee retirement systems. They are not intended to present fairly the financial position and results of operations of the entire County.

A. Plan Description and Contribution Information

Membership. At June 30, 2002, the date of the latest actuarial valuation, membership in the System consisted of:

Retirees and beneficiaries receiving benefits	4,115
Terminated plan members entitled to but not yet receiving benefits	427
Active plan members	5,989

Plan Description. The System, a cost-sharing multiple-employer defined benefit pension plan, was established in 1965 and is sponsored by Montgomery County. Other agencies or political subdivisions have the right to elect participation. The Plan is closed to employees hired on or after October 1, 1994, except public safety bargaining unit employees. All covered full-time employees of the County and participating agencies must become members of the System as a condition of employment. All covered career part-time employees of the County and participating agencies may become members on an individual basis.

Funding Policy and Contributions. The System is a contributory plan with employees contributing a percentage of their base annual salary. Contribution rates range from 4 percent to 8.5 percent of regular earnings annually based on group classification and contributions earn interest at the rate of 4 percent per annum as specified under Section 33-39(a) of the Montgomery County Code of 1994, as amended. The County and each participating agency are required to contribute the remaining amounts necessary to fund the System using the actuarial basis as specified in Section 33-40 of the Montgomery County Code of 1994, as amended.

Benefit provisions. All benefits vest at five years of service. Normal retirement benefits are 2 percent of the final 12 months' regular basic earnings for members enrolled prior to July 1, 1978, or 2 percent of the final 36 month average for members enrolled after June 30, 1978 multiplied by years of credited service (maximum 36 years) adjusted for cost of living. Benefit provisions are established under Section 33-42

NOTES TO THE FINANCIAL STATEMENTS

of the Montgomery County Code of 1994, as amended. For most members, normal retirement is age 60 with five years of service or various combinations of age and years of service based on participation group. Members who retire early receive normal retirement benefits reduced by a minimum of 2 percent to a maximum of 60 percent depending on the number of years early retirement precedes normal retirement. The System provides options for disability and death benefits to eligible participants. Annual cost-of-living adjustments are provided to retirees and beneficiaries based on the percentage increase in the Consumer Price Index. Legislation enacted by the Montgomery County Council in November 1999 required the Chief Administrative Officer of the County to establish Deferred Retirement Option Plans, or DROP Plans, allowing any employee who is a member of a specified membership group or bargaining unit, and who meets certain eligibility requirements, to elect to "retire" but continue to work for a specified time period, during which pension payments are deferred. When the member's participation in the DROP Plan ends, the member must stop working for the County, draw a pension benefit based on the member's credited service and earnings as of the date that the member began to participate in the DROP Plan, and receive the value of the DROP Plan payoff. During fiscal year ("FY") 2002 total disbursements under the DROP Plan amounted to \$386,198.

B. Summary of Significant Accounting Policies

Basis of Accounting. The System's financial statements have been prepared under the accrual basis of accounting. Member and employer contributions are recognized in the period in which the contributions are due. Benefits and refunds are recognized when due in accordance with the terms of the Plan. The cost of administering the Plan is paid by the System. During 2002, the Board implemented Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments*, and Statement No. 37, *Basic Financial Statements-Management's Discussion and Analysis-for State and Local Governments: Omnibus*. The primary impact of these statements is the addition of a Management's Discussion and Analysis (MD&A) section presented as required supplementary information.

Method Used to Value Investments. Investments are stated at fair value. The fair value is generally based on quoted market prices at June 30, 2002. Fair value for real estate investments is determined using unit values supplied by the issuers, which are based upon the issuers' appraisals of underlying real estate values. Such values involve subjective judgment and may differ from amounts which would be realized if such real estate was actually sold. Cash received as collateral on securities lending transactions and investments made with such cash are reported as assets along with a related liability for collateral received.

Equity in County's pooled cash and investments. The System maintains its cash with the County, which invests cash and allocates interest earned, on a quarterly basis to the System based on the System's average daily balance of its equity in pooled cash. The County fully collateralizes the cash maintained in the pool.

C. Trustees of the Plan

Montgomery County established a Board of Investment Trustees for the System to be responsible for the investment management of the System's assets for the exclusive benefit of the members. The Board consists of nine members appointed by the County Executive.

D. Investments

Section 33-61 of the Montgomery County Code of 1994, as amended, authorizes the Board of Investment Trustees to purchase investments with the care, skill, prudence and diligence under the circumstances that a prudent person acting in a similar capacity and familiar with the same matters

FINANCIAL SECTION

NOTES TO THE FINANCIAL STATEMENTS

would use to conduct a similar enterprise with similar purposes. Such investments shall be diversified so as to minimize the risk of large losses unless it is clearly not prudent to diversify under the circumstances.

Derivatives. The System invests in derivative instruments on a limited basis in accordance with the Board of Investment Trustees' policy. During FY 2002, the System invested directly in various derivatives including asset-backed securities, collateralized mortgage obligations (CMOs), bond index future contracts, forward currency contracts, and floating rate securities. Investment managers are specifically prohibited from purchasing securities on margin or leverage. The System entered into these investments either to increase earnings or to hedge against potential losses. These investments generally contain market risk resulting from fluctuations in interest and currency rates. The credit risk of these investments is associated with the creditworthiness of the related parties to the contracts. At June 30, 2002, direct investments in derivatives represented one percent of the total fair value of the System's portfolio. In addition, the System has indirect exposure to market and credit risk through its ownership interests in certain mutual funds which hold derivative financial instruments.

Security Lending. Board of Investment Trustees' policies permit the System to lend its securities to broker-dealers and other entities (borrowers) for collateral that will be returned for the same securities in the future. The System's custodian is the agent in lending the System's securities for collateral of 102 percent for domestic and 105 percent for international securities. The custodian receives cash, securities or irrevocable bank letters of credit as collateral. All securities loans can be terminated on demand by either the System or the borrower. The relationship between the maturities of the investment pool and the System's loans is affected by the maturities of securities loans made by other plan entities that invest cash collateral in the investment pool, which the System cannot determine.

The System does not restrict the amounts of loans the lending agent may make on its behalf. The agent indemnifies the System by agreeing to purchase replacement securities, or return the cash collateral thereof, in the event a borrower fails to return loaned securities or pay distributions thereon. There were no such failures by any borrower during the fiscal year, nor were there any losses during the period resulting from a default of the borrower or lending agent.

Securities on loan for securities, or irrevocable letters of credit collateral are classified in the following schedule of investments according to the category of the collateral received. As of June 30, 2002, the market value of securities on loan was \$229,872,139. Cash received as collateral and the related liability of \$225,451,924 as of June 30, 2002, is shown on the Statement of Plan Net Assets. Securities received as collateral are not reported as assets since the System does not have the ability to pledge or sell the collateral securities absent borrower default.

Concentrations. The System does not have investments (other than U.S. Government and U.S. Government guaranteed obligations) in any one organization that represent 5 percent or more of net assets held in trust for pension benefits.

Credit Risk. The System's investments are categorized to give an indication of the level of risk assumed by the System at year end. Category 1 includes investments that are insured or registered or for which the securities are held by the System or its agent in the System's name. Category 2 includes uninsured and unregistered investments for which the securities are held by a counterparty's trust department or agent in the System's name. Category 3 includes uninsured and unregistered investments for which the securities are held by a counterparty or its trust department or agent, but not in the System's name. All of the System's categorized investments meet the criteria of Category 1. Investments that by their nature are not required to be categorized include mutual funds, commingled funds (pooled investment vehicles), real estate holdings, short-term collateral investment pools and those securities on loan for which the cash collateral is invested in the collateral investment pool.

FINANCIAL SECTION

NOTES TO THE FINANCIAL STATEMENTS

(Continued)

Schedule of investments as of June 30, 2002:

Categorized investments

Short-term investments	\$ 45,970,757
U.S. Government obligations-not on securities loan	109,307,510
Asset-backed securities	19,125,586
Corporate bonds	154,286,566
Common and preferred stock:	
Not on securities loan	667,738,246
On securities loan for securities collateral	<u>1,685,818</u>
Total categorized investments	<u>998,114,483</u>

Uncategorized investments

Mutual and commingled funds	444,043,247
Securities lending short-term collateral investment pool	225,451,924
Investments held by broker dealers under securities loans with cash collateral:	
Common and preferred stock	119,191,165
Corporate bonds	31,151,382
Government obligations	68,542,575
Real estate holdings	<u>9,206,461</u>
Total uncategorized investments	<u>897,586,754</u>

Total investments \$ 1,895,701,237

E. Capital Assets

Capital assets consist of office equipment and are stated at cost. Depreciation is recognized as an expense over a 5 year estimated useful life using the straight-line method.

F. Allocated Insurance Contract

On August 1, 1986, Montgomery County entered into an agreement with Aetna Life Insurance Company (Aetna) wherein Aetna accepted future responsibility for monthly payments to all members retired prior to January 1, 1986, in exchange for a lump sum payment. The County is liable for cost of living increases effective January 1, 1986, and later. The transactions related to this agreement have not been recognized in the System's financial statements.

G. Income Taxes

The Internal Revenue Service issued a determination letter in January 1997, which stated that the System and its underlying trust qualify under the applicable provisions of the Internal Revenue Code and therefore are exempt from federal income taxes. In the opinion of the plan administrator, the System and its underlying trust have operated within the terms of the System and are qualified under the applicable provisions of the Internal Revenue Code.

FINANCIAL SECTION

NOTES TO THE FINANCIAL STATEMENTS

(Continued)

RETIREMENT SAVINGS PLAN - Defined Contribution Pension Plan

The Montgomery County Retirement Savings Plan ("Plan") is considered part of the County of Montgomery, Maryland's ("County") financial reporting entity and is included in the County's general purpose financial statements as a pension trust fund. The accompanying financial statements present only the operations of the Plan in conformity with GAAP. They are not intended to present fairly the financial position and results of operations of the entire County.

A. Plan Description and Contribution Information

Membership. At June 30, 2002 membership in the Plan consisted of 2,908 active plan members.

Plan Description. The Plan, a cost-sharing multiple-employer defined contribution plan, was established in 1994 and is sponsored by Montgomery County. Other agencies or political subdivisions have the right to elect participation. All non-public safety and certain public safety employees hired on or after October 1, 1994 are covered by the Plan. Employees covered by the Montgomery County Employees' Retirement System may make an irrevocable decision to transfer to this Plan.

Contributions. Under Section 33-116 of the Montgomery County Code of 1994, as amended, the Plan requires employees contribute 3 percent of regular earnings up to the Social Security wage base and 6 percent above the Social Security wage rate. Section 33-117 of the Montgomery County Code requires the County to contribute 6 percent and 10 percent of regular earnings for non-public safety and public safety employees, respectively.

Benefit provisions. Employee contributions vest immediately and employer contributions are vested after three years of service or upon death, disability, or retirement age of the employee.

B. Summary of Significant Accounting Policies

Basis of Accounting. The Plan's financial statements have been prepared under the accrual basis of accounting. Member contributions are recognized in the period in which the contributions are due. Benefits and refunds are recognized when due in accordance with the terms of the Plan. The cost of administering the Plan is paid by Montgomery County. During 2002, the Board implemented Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments*, and Statement No. 37, *Basic Financial Statements-Management's Discussion and Analysis-for Statement and Local Governments: Omnibus*. The primary impact of these statements is the addition of a Management's Discussion and Analysis (MD&A) section.

Method Used to Value Investments. Investments are stated at fair value. The fair value is generally based on quoted market prices at June 30, 2002.

Equity in County's pooled cash and temporary investments. The Plan maintains its cash with the County, which invests cash and allocates interest earned, net of a management fee, on a daily basis to the Plan based on the Plan's average daily balance of its equity in pooled cash. The County fully collateralizes the cash maintained in the pool.

NOTES TO THE FINANCIAL STATEMENTS

(Continued)

C. Trustees of the Plan

Montgomery County established a Board of Investment Trustees for the Trust. The Board consists of nine members appointed by the County Executive.

D. Investments

Section 33-125 of the Montgomery County Code authorizes the Board of Investment Trustees to establish a diversified slate of mutual and commingled investment funds from which participants may select an option. The Board exercises the Standard of Care as delineated in Section 33-61. The Plan's investments are categorized to give an indication of the level of risk assumed by the Plan at year end. Category 1 includes investments that are insured or registered or for which the securities are held by the Plan or its agent in the Plan's name. Category 2 includes uninsured and unregistered investments for which the securities are held by a counterparty's trust department or agent in the Plan's name. Category 3 includes uninsured and unregistered investments for which the securities are held by a counterparty or its trust department or agent, but not in the Plan's name. All of the Plan's investments include mutual and commingled funds (pooled investment vehicles) and are therefore not required to be categorized.

Schedule of investments as of June 30, 2002:

Uncategorized Investments

Mutual and commingled funds	\$26,502,116
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E. Income Taxes

The Internal Revenue Service issued a determination letter in 1997, which stated that the Plan and its underlying trust qualify under the applicable provisions of the Internal Revenue Code and therefore are exempt from federal income taxes. In the opinion of the plan administrator, the Plan and its underlying trust have operated within the terms of the Plan and are qualified under the applicable provisions of the Internal Revenue Code.

FINANCIAL SECTION

NOTES TO THE FINANCIAL STATEMENTS

(Continued)

Deferred Compensation Plan

The employees of Montgomery County may participate in the Montgomery County Deferred Compensation Plan (the Plan). The purpose of the Plan is to extend to employees a deferred compensation plan pursuant to Section 457 of the Internal Revenue Code of 1954, as amended. During 1999, in accordance with Federal legislation, the assets of the Plan were placed in trust for the sole benefit of participants and their beneficiaries. The accompanying financial statements present only the operations of the Plan in conformity with GAAP. They are not intended to present fairly the financial position and results of operations of the entire County.

A. Plan Description and Contribution Information

Plan description and contributions. The Board of Investment Trustees has contracts with Hartford Life Insurance Companies and Fidelity Investments to provide investment vehicles for plan participants. Under the Plan, contributions are sent to the providers for different types of investments as selected by the participants. A separate account, which reflects the monies deferred, investment of the monies, and related investment earnings is maintained for each participant by the provider. Withdrawals are made upon retirement, termination of employment, death, and/or in unforeseeable emergencies.

B. Summary of Significant Accounting Policies

Basis of Accounting. The Plan's financial statements have been prepared under the accrual basis of accounting. Member contributions are recognized in the period in which the contributions are due. Distributions are recognized when paid in accordance with the terms of the Plan. The costs of administering the Plan are recognized as incurred. During 2002, the Board implemented Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments*, and Statement No. 37, *Basic Financial Statements-Management's Discussion and Analysis-for Statement and Local Governments: Omnibus*. The primary impact of these statements is the addition of a Management's Discussion and Analysis (MD&A) section and the change in fund type discussed in Note E below.

Method Used to Value Investments. Investments are stated at fair value. The fair value is generally based on quoted market prices at June 30, 2002.

C. Trustees of the Plan

Montgomery County established a Board of Investment Trustees for the Trust. The Board consists of nine members appointed by the County Executive.

D. Investments

The Board of Investment Trustees is required to establish a diversified slate of mutual and commingled funds from which participants may select investment options. The Board exercises the Standard of Care as delineated in Section 33.61 of the Montgomery County Code. The Plan's investments are categorized to give an indication of the level of risk assumed by the Plan at year end. Category 1 includes investments that are insured or registered or for which the securities are held by the Plan or its agent in the Plan's name. Category 2 includes uninsured and unregistered investments for which the securities are held by a counterparty's trust department or agent in the Plan's name. Category 3 includes uninsured and unregistered investments for which the securities are held by a counterparty or its trust department or agent, but not in the Plan's name. All of the Plan's investments include mutual and commingled funds (pooled investment vehicles) and are therefore not required to be categorized.

NOTES TO THE FINANCIAL STATEMENTS

(Continued)

Schedule of investments as of June 30, 2002:

Uncategorized Investments

Mutual and commingled funds	\$184,150,051
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E. Prior Period Adjustment

A primary impact of the implementation of Governmental Accounting Standards Board Statement No. 34 is that the deferred compensation plan, previously reported as an expendable trust fund on the modified accrual basis of accounting, is now reported as a pension and other employee benefit trust fund on the full accrual basis of accounting. In conjunction with this change in basis of accounting, net assets held in trust for pension benefits as of June 30, 2001, has been restated by \$724,547, to reflect an increase in contributions receivable.

FINANCIAL SECTION

REQUIRED SUPPLEMENTARY INFORMATION

Historical trend information about the Employees' Retirement System defined benefit pension plan is presented herewith as required supplementary information. This information is intended to help users assess the System's funding status on a going-concern basis, assess progress made in accumulating assets to pay benefits when due, and make comparisons with other public employee retirement systems.

SCHEDULE OF FUNDING PROGRESS

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
6/30/97	\$1,317,475,134	\$1,582,565,673	\$265,090,539	83.2%	\$272,262,031	97.4%
6/30/98	1,496,651,390	1,660,034,038	163,382,648	90.2%	278,364,575	58.7%
6/30/99	1,707,450,187	1,818,990,623	111,540,436	93.9%	282,220,066	39.5%
6/30/00	1,911,114,401	1,931,914,313	20,799,912	98.9%	299,649,316	6.9%
6/30/01	1,990,882,017	2,111,946,453	121,064,436	94.3%	290,751,709	41.6%
6/30/02	2,036,100,709	2,273,179,216	237,078,507	89.6%	298,456,852	79.4%

Analysis of the dollar amounts of plan net assets, actuarial accrued liability, and unfunded actuarial accrued liability in isolation can be misleading. Expressing the assets as a percentage of the actuarial accrued liability provides one indication of the System's funding status on a going-concern basis. Analysis of this percentage over time indicates whether the system is becoming financially stronger or weaker. Generally, the greater this percentage, the stronger the system. Trends in the unfunded actuarial accrued liability and annual covered payroll are both affected by inflation. Expressing the unfunded actuarial accrued liability as a percentage of annual covered payroll approximately adjusts for the effects of inflation and aids analysis of the system's progress made in accumulating sufficient assets to pay benefits when due. Generally, the smaller this percentage, the stronger the system.

SCHEDULE OF EMPLOYER CONTRIBUTIONS

Fiscal Year Ended June 30	Annual Required Contribution	Percentage Contributed
1997	\$49,762,655	100%
1998	51,097,622	100%
1999	47,462,625	100%
2000	44,347,078	100%
2001	43,345,296	100%
2002	39,168,622	100%

NOTES TO REQUIRED SUPPLEMENTARY INFORMATION

The information presented in the required supplementary schedules was determined as part of the actuarial valuation at the date indicated. Additional information as of the latest actuarial valuation follows.

Valuation date	June 30, 2002
Actuarial cost method	Projected unit credit
Amortization method	Level dollar amount
Remaining amortization period	40 year period based on closed periods
Asset valuation method	5-Year phase-in of market gains/losses
Actuarial assumptions:	
Investment rate of return	8.0%
Projected salary increases	4.0%
Cost-of-living adjustments	4.0%
Post-Retirement Increases	Consumer Price Index - by Group
Mortality rates after retirement	Group Annuity - 1983 table

The actuarial assumptions used have been recommended by the actuary and adopted by the County's Chief Administrative Officer based on the most recent review of the System's experience, completed as of June 30, 2002.

The rate of employer contributions to the plan is composed of the normal cost, amortization of the unfunded actuarial liability and an allowance for administrative expenses. The normal cost is a level percent of pay cost which, along with the member contributions, will pay for projected benefits at retirement for the average plan participant. The actuarial liability is that portion of the present value of projected benefits that will not be paid by future employer normal costs or member contributions. The difference between this liability and the funds accumulated as of the same date is the unfunded actuarial liability.

FINANCIAL SECTION

SCHEDULE OF ADMINISTRATIVE, INVESTMENT AND PROFESSIONAL FEES EMPLOYEES' RETIREMENT SYSTEM

Year ended June 30, 2002

SCHEDULE OF ADMINISTRATIVE EXPENSES

Personnel services

Salaries and wages	\$726,971
Retirement contributions	50,833
Insurance	51,183
Social Security	<u>56,427</u>
Total personnel services	885,414

Professional services

Actuarial	285,417
Independent Public Accountants	<u>25,200</u>
Total professional services	310,617

Communications

Computer	42,823
Printing	17,235
Postage	<u>26,541</u>
Total communications	86,599

Supplies

Office supplies	41,285
Dues and subscriptions	<u>13,864</u>
Total supplies	55,149

Other services and charges

Due Diligence and Education	47,221
Disability Management	247,583
Rent & Related Charges	91,323
Benefit Disbursement	204,851
Software	136,231
Miscellaneous	<u>27,376</u>
Total other services and charges	754,585

Total administrative expenses **\$2,092,364**

SCHEDULE OF PROFESSIONAL/CONSULTANT FEES

Professional/Consultant fees

William M. Mercer, Inc.	\$285,417
KPMG LLP	<u>25,200</u>

Total professional services fees **\$310,617**

FINANCIAL SECTION

SCHEDULE OF ADMINISTRATIVE, INVESTMENT AND PROFESSIONAL FEES EMPLOYEES' RETIREMENT SYSTEM

(Continued)

SCHEDULE OF INVESTMENT EXPENSES

Investment Managers

Aetna Life Insurance Companies	\$ 1,611
Northern Trust	263,125
State Street Bank and Trust Co.	4,772
BlackRock Financial	470,312
Lazard Asset Mgt.	619,268
State Street Global Advisors	14,093
RhumbLine Advisors	124,292
Systematic Financial	652,611
William Blair	478,166
Barclays	70,050
Numeric Investors	1,057,169
WR Huff	593,067
JP Morgan	563,190
Capital Guardian	547,305
Fidelity Investments	<u>3,812</u>

Total investment management fees **5,462,843**

Other Investment Related Expenses

Bloomberg Financial Systems	18,992
Wilshire Associates	167,820
Abel/Noser Corp.	5,000
Securities lending borrower rebates	3,142,576
Securities lending agent fees	<u>249,325</u>

Total other investment expenses **3,583,713**

Total investment expenses **\$9,046,556**

FINANCIAL SECTION

EMPLOYEES' RETIREMENT SYSTEM STATEMENTS OF PLAN NET ASSETS

June 30, 2002 and 2001

Assets	2002	2001
Equity in County's pooled cash and investments	<u>\$ 552,876</u>	<u>\$1,253,886</u>
Investments		
U.S. Government and agency obligations	177,357,723	88,259,089
Asset-backed securities	19,125,586	249,867,229
Municipal bonds	492,362	-
Corporate bonds	185,437,948	220,142,063
Common and preferred stock	788,615,229	862,710,569
Mutual and commingled funds	444,043,247	305,718,248
Short-term investments	45,970,757	86,486,896
Cash collateral received under securities lending agreements	225,451,924	39,556,169
Real estate holdings	<u>9,206,461</u>	<u>13,816,048</u>
Total investments	<u>1,895,701,237</u>	<u>1,866,556,311</u>
Dividends receivable and accrued interest	6,717,506	9,904,589
Contributions receivable	2,142,910	2,085,507
Capital assets, at cost:		
Office equipment	111,375	111,375
Less: accumulated depreciation	<u>111,375</u>	<u>111,375</u>
Net capital assets	<u>-</u>	<u>-</u>
Total assets	<u>1,905,114,529</u>	<u>1,879,800,293</u>
Liabilities		
Payable for collateral received under securities lending agreements	225,451,924	39,556,169
Benefits payable and other liabilities	<u>2,142,487</u>	<u>2,562,724</u>
Total liabilities	<u>227,594,411</u>	<u>42,118,893</u>
Net assets held in trust for pension benefits	<u>\$1,677,520,118</u>	<u>\$1,837,681,400</u>

EMPLOYEES' RETIREMENT SYSTEM
STATEMENTS OF CHANGES IN PLAN NET ASSETS
Years Ended June 30, 2002 and 2001

Additions	2002	2001
Contributions		
Employer	\$39,168,622	\$43,345,296
Members	<u>12,943,679</u>	<u>11,291,541</u>
Total contributions	<u>52,112,301</u>	<u>54,636,837</u>
Investment Income		
Net appreciation (depreciation) in fair value of investments	(168,295,240)	(136,055,502)
Dividends and interest	49,772,438	59,453,839
Income from securities lending activities	3,391,901	6,229,317
Other	<u>-</u>	<u>1,697,542</u>
Total investment loss	(115,130,901)	(68,674,804)
Less investment expenses	<u>9,046,556</u>	<u>12,699,974</u>
Net investment loss	<u>(124,177,457)</u>	<u>(81,374,778)</u>
Total reductions	<u>(72,065,156)</u>	<u>(26,737,941)</u>
Deductions		
Retiree benefits	64,030,235	58,415,300
Disability benefits	17,250,631	16,234,205
Survivor benefits	4,041,521	3,785,049
Refunds	681,375	1,066,708
Administrative expenses	<u>2,092,364</u>	<u>1,688,780</u>
Total deductions	<u>88,096,126</u>	<u>81,190,042</u>
Net decrease	<u>(160,161,282)</u>	<u>(107,927,983)</u>
Net assets held in trust for pension benefits		
Beginning of year	<u>1,837,681,400</u>	<u>1,945,609,383</u>
End of year	<u>\$1,677,520,118</u>	<u>\$1,837,681,400</u>

FINANCIAL SECTION

RETIREMENT SAVINGS PLAN STATEMENTS OF PLAN NET ASSETS

June 30, 2002 and 2001

<i>Assets</i>	<i>2002</i>	<i>2001</i>
Equity in County's pooled cash and investments	\$1,851,609	\$1,893,714
Investments	26,502,116	21,727,653
Contributions receivable	<u>466,240</u>	<u>434,528</u>
Total assets	<u>28,819,965</u>	<u>24,055,895</u>
<i>Liabilities</i>		
Accrued expenses	<u>44,061</u>	<u>146,835</u>
<i>Net assets held in trust for pension benefits</i>	<u>\$28,775,904</u>	<u>\$23,909,060</u>

FINANCIAL SECTION

RETIREMENT SAVINGS PLAN STATEMENTS OF CHANGES IN PLAN NET ASSETS Years Ended June 30, 2002 and 2001

Additions	2002	2001
Contributions		
Employers	\$5,791,248	\$4,866,825
Members	<u>3,307,782</u>	<u>2,582,452</u>
Total contributions	<u>9,099,030</u>	<u>7,449,277</u>
Investment loss	(3,268,193)	(2,528,166)
Less investment expenses	<u>214,211</u>	<u>250,872</u>
Net investment loss	<u>(3,482,404)</u>	<u>(2,779,038)</u>
Other income	<u>282,481</u>	<u>418,610</u>
Total additions	<u>5,899,107</u>	<u>5,088,849</u>
Deductions		
Refunds	944,749	1,516,958
Administrative expenses	<u>87,514</u>	<u>49,306</u>
Total deductions	<u>1,032,263</u>	<u>1,566,264</u>
Net increase	<u>4,866,844</u>	<u>3,522,585</u>
Net assets held in trust for pension benefits		
Beginning of year	<u>23,909,060</u>	<u>20,386,475</u>
End of year	<u>\$28,775,904</u>	<u>\$23,909,060</u>

FINANCIAL SECTION

DEFERRED COMPENSATION PLAN **Statements of Plan Net Assets** June 30, 2002 and 2001

Assets	2002	2001
Investments	\$184,150,051	\$199,623,317
Contributions receivable	<u>840,009</u>	<u>724,547</u>
Total assets and net assets held in trust for pension benefits	<u>\$184,990,060</u>	<u>\$200,347,864</u>

FINANCIAL SECTION

DEFERRED COMPENSATION PLAN STATEMENTS OF CHANGES IN PLAN ASSETS

Years Ended June 30, 2002 and 2001

Additions	2002	2001
Contributions		
Members	<u>\$20,085,620</u>	<u>\$18,667,087</u>
Investment loss	<u>(25,496,678)</u>	<u>(27,691,629)</u>
Total reductions	<u>(5,411,058)</u>	<u>(9,024,542)</u>
Deductions		
Member refunds	9,898,079	4,758,067
Administrative expenses	<u>48,667</u>	<u>61,405</u>
Total deductions	<u>9,946,746</u>	<u>4,819,472</u>
Net decrease	<u>(15,357,804)</u>	<u>(13,844,014)</u>
Net assets held in trust for pension benefits		
Beginning of year	<u>200,347,864</u>	<u>214,191,878</u>
End of year	<u>\$184,990,060</u>	<u>\$200,347,864</u>

INVESTMENT SECTION

Employees' Retirement System

Investment Performance, Policy, Statistics and Activity

For the fiscal year, the System's investment return was a loss of 6.7 percent. Return data for the System was calculated on a time weighted basis in accordance with the standards of the Association of Investment Management & Research (AIMR) by the System's custodian bank, The Northern Trust Company. Valuations are based on published national securities exchange prices, where available, and all valuations are reconciled between the various investment managers and the custodian bank. The following pages were prepared by the Board of Investment Trustees staff.

In the investment of public funds, adequate funding of employee retirement benefits at a reasonable and affordable cost is a paramount concern. An appropriate balance must be struck between risks taken and returns sought to ensure the long term health of the System. The Board of Investment Trustees has adopted an investment policy that works to control the extent of downside risk to which the System is exposed while maximizing the potential for long term increases in the value of assets.

Specific investment objectives include:

- To realize the actuarial assumed rate of return of 8 percent, annually.
- To manage portfolio risk so as to limit potential downside fluctuations in the value of the total System assets.
- To realize as high a rate of total return as possible consistent with the above.

To achieve these objectives, the following investment policies are employed:

- Allocate System assets to a broad array of investment sectors as follows: Domestic equities 50%, international equities 15%, domestic fixed income 30% and TIPS 5%.
- Maintain the asset allocation stated above, within a +/-3% range.
- Monitor the individual investment manager's market value to ensure compliance with the Board's Manager Funding Policy.
- Evaluate the performance of all investment managers against their specific performance and style objectives and against the returns achieved by other similar managers.
- Evaluate the System's overall risk exposure and modify investments through rebalancing when necessary.

Charts and tables are enclosed indicating the System's:

- Asset allocation
- Investment managers with assignments
- List of largest assets held
- Investment performance for various periods

INVESTMENT SECTION

EMPLOYEES' RETIREMENT SYSTEM INVESTMENT SUMMARY ASSET ALLOCATION BY CATEGORY AND INVESTMENT MANAGER

<i>Asset Class Manager</i>	<i>Investment Style</i>	<i>Fair Value \$(000)</i>	<i>% of Total Fair Value</i>
Domestic Equities			
BGI Russell 3000 Fund*	Passive Russell 3000 Index	\$189,173	11.3%
RhumbLine Advisors	Passive Russell 1000 Index	136,341	8.1%
Systematic Financial Mgt.	Active Large Cap Value	174,581	10.4%
Numeric Investors	Active Large Cap Core	115,876	6.9%
RhumbLine Advisors	Passive Russell 1000 Growth Index	50,803	3.0%
Numeric Investors	Active Small Cap Growth	56,010	3.3%
William Blair	Active Small Cap Value	68,566	4.1%
Fidelity Investments*	Commingled Funds	4,974	0.3%
International Equities			
Lazard Asset Mgt.	Active EAFE	122,785	7.3%
Capital Guardian	Active EAFE	94,907	5.7%
Capital Guardian*	Active Emerging Mkts. Fund	25,679	1.5%
BGI EAFE Fund*	Passive EAFE Index	16,366	1.0%
Real Estate			
Total Real Estate Funds*	Active Equity	9,209	0.6%
Fixed Income			
JP Morgan	Active Core	197,983	11.8%
BlackRock	Active Core	194,536	11.6%
WR Huff	High Yield	105,110	6.3%
BGI TIPS Fund*	Passive TIPS	83,454	5.0%
BGI US Debt Fund*	Passive Lehman Aggregate Index	17,530	1.0%
Cash*	Active Short Term	<u>13,637</u>	<u>0.8%</u>
Total Assets**		<u>\$ 1,677,520</u>	<u>100.0%</u>

* Pooled Funds

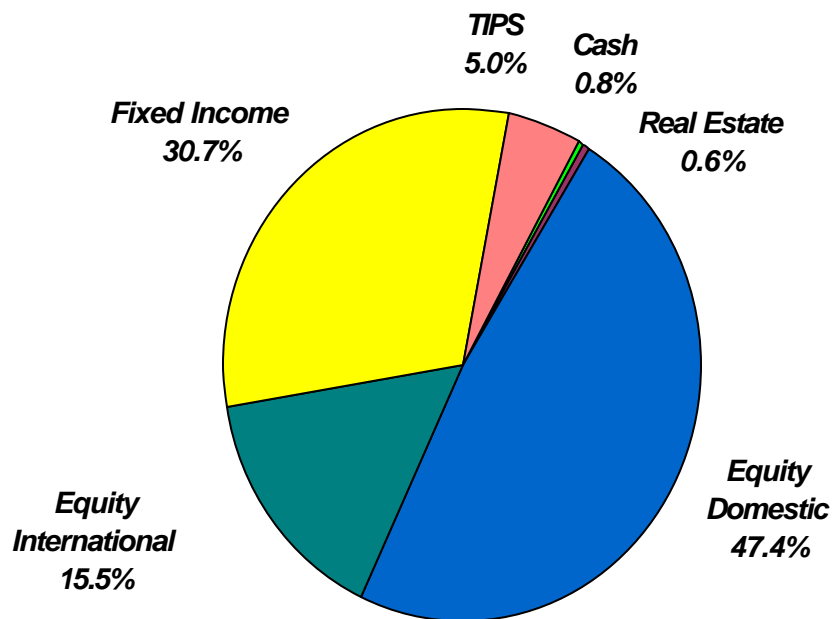
**Without Cash Collateral and Contributions Receivable.

INVESTMENT SECTION

EMPLOYEES' RETIREMENT SYSTEM

Asset Allocation

June 30, 2002



**EMPLOYEES' RETIREMENT SYSTEM
LIST OF LARGEST ASSETS HELD**

(June 30, 2002)

<i>Fifteen Largest Equity Holdings</i>	<i>Shares</i>	<i>Market Value</i>
General Electric	360,092	\$ 10,460,673
Johnson & Johnson	188,479	9,849,913
Pfizer	260,066	9,102,310
Microsoft Corp.	162,250	8,875,075
Cisco Systems	531,320	7,411,914
Bank of America Corp.	105,334	7,411,300
Wal-Mart Stores	111,317	6,123,548
Exxon Mobil Corp.	148,714	6,085,377
American International Group	86,940	5,931,916
Proctor & Gamble	66,100	5,902,730
Verizon Communications	141,720	5,690,058
Novartis	128,281	5,641,520
Federal National Mortgage Association	69,600	5,133,000
Citigroup	131,934	5,112,443
Anthem	75,400	5,087,992

<i>Fifteen Largest Fixed Income Holdings</i>	<i>Interest Rate</i>	<i>Maturity Date</i>	<i>Market Value</i>
Federal National Mortgage Assn. Single Family July 30-year	6.000%	July 14, 2029	\$ 21,824,664
United States Treasury Notes	4.375%	May 15, 2007	18,840,544
Government National Mortgage Assn.	6.500%	July 15, 2028	13,255,970
Federal National Mortgage Assn.	7.000%	July 1, 2029	11,592,000
Federal Home Loan Mortgage Corp.	6.500%	July 1, 2030	11,216,590
United States Treasury Notes	3.000%	January 31, 2004	8,284,631
United States Treasury Bonds	8.125%	August 15, 2019	8,005,000
United States Treasury Bonds	8.000%	November 15, 2021	7,477,567
United States Treasury Bonds	6.250%	May 15, 2030	5,789,597
Federal Home Loan Mortgage Corp.	6.000%	July 1, 2028	5,484,545
Federal Home Loan Mortgage Corp.	7.000%	July 1, 2029	4,141,240
United States Treasury Bonds	10.375%	November 15, 2012	3,900,552
Federal National Mortgage Assn.	5.500%	April 1, 2017	3,585,551
Federal National Mortgage Assn.	6.000%	November 1, 2028	3,449,212
Federal National Mortgage Assn.	5.500%	December 1, 2013	3,306,707

A complete list of the portfolio holdings can be obtained by contacting the Board of Investment Trustees office.

INVESTMENT SECTION

EMPLOYEES' RETIREMENT SYSTEM SCHEDULE OF INVESTMENT RESULTS As of June 30, 2002

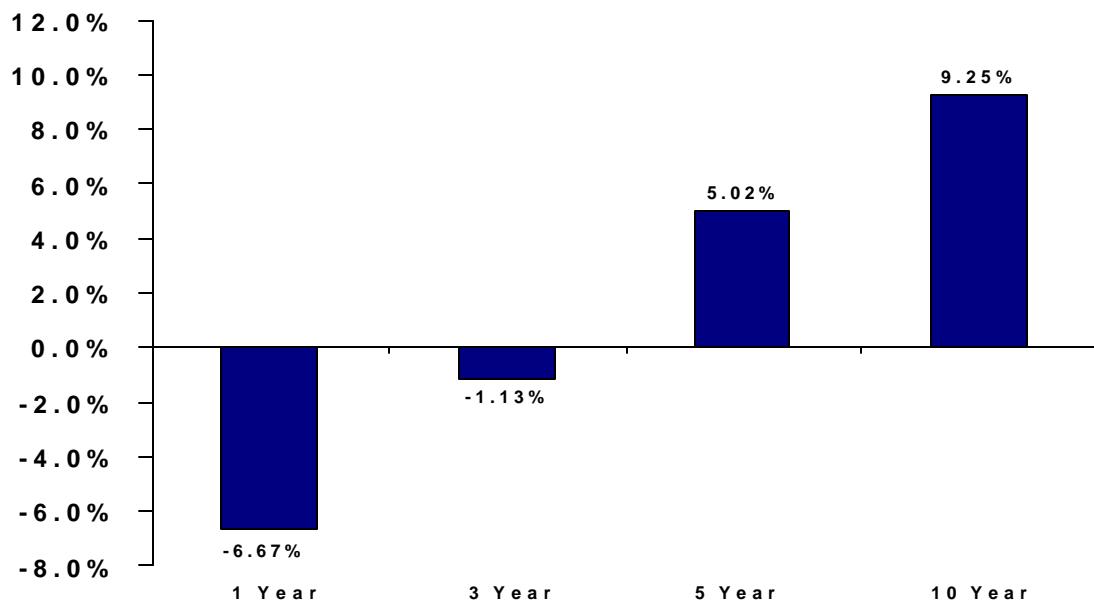
<i>Asset Class Manager</i>	<i>1 Year</i>	<i>3 Year</i>	<i>5 Year</i>
Domestic Equities			
BGI Russell 3000 Fund*	-	-	-
RhumbLine Advisors-Russell 1000	(17.73)%	(8.45)%	3.85%
Systematic Financial Mgt.	(12.58)	(0.11)	7.49
Numeric Investors-Core	(13.58)	(3.59)	6.92
RhumbLine Advisors-Russell 1000 Growth	(26.49)	(24.64)	(8.42)
Numeric Investors-Small Cap	(11.72)	0.05	5.11
William Blair*	17.42	-	-
Combined Domestic Equities	(13.57)%	(5.62)%	4.34 %
**Russell 3000	(17.24)	(7.92)	3.84
International Equities			
Lazard Asset Mgt.	(9.43)%	(4.99)%	0.97%
Capital Guardian-Total*	(8.95)	-	-
Capital Guardian-Emerging Markets*	(5.14)	-	-
BGI EAFE Fund*	-	-	-
Combined International Equities	(9.58)%	(6.18)%	(0.52)%
**MSCI All Country World X Us	(8.16)	(6.16)	(1.70)
Real Estate			
Total Real Estate Funds	(1.02)%	4.53%	5.52%
Fixed Income			
JP Morgan	7.93%	8.35%	7.58%
BlackRock*	8.95	8.54	-
WR Huff	(10.74)	(2.12)	2.21
BGI TIPS Fund*	-	-	-
BGI US Debt Fund*	-	-	-
Combined Fixed Income	4.64%	6.42%	6.81%
**Salomon Brothers Broad	5.92	5.96	6.19
Total Fund	(6.67)%	(1.13)%	5.02%

*Returns are not available for years indicated.

** Benchmark indexes.

EMPLOYEES' RETIREMENT SYSTEM

*Compound Annual Return
on Investment Portfolio*



ACTUARIAL SECTION

MERCER

Human Resource Consulting

120 East Baltimore Street, 20th Floor
Baltimore, MD 21202-1674
410 727 3345 Fax 410 727 3347
www.mercerHR.com

November 12, 2002

Board of Investment Trustees
Montgomery County Government Retirement System
101 Monroe Street
Rockville, MD 20850

Subject:

July 1, 2002 Actuarial Valuation Report

Dear Members of the Board:

Mercer Human Resource Consulting annually performs an actuarial valuation of the Montgomery County Employees' Retirement System for the Montgomery County Government. The most recent actuarial valuation performed was as of July 1, 2002. The purposes of this valuation were to:

- Review experience under the Plan for the year ending June 30, 2002
- Determine the liabilities of the Plan as of June 30, 2002
- Determine the contribution to be paid biweekly during the fiscal year ending June 30, 2004.

The actuarial information in this letter is provided in detail in our valuation report.

Valuation Results

Sections II through IV of the valuation report detail the results of the 2002 valuation, including a breakdown by employee group and plan. There was no change in plan provisions or actuarial assumptions from the 2001 valuation.

County Contributions

Contributions are computed using the Projected Unit Credit method of funding. The objective of this method is to fund each participant's benefits under the Plan, as they would accrue, taking into consideration future salary increases. Thus the total pension to which each participant is expected to become entitled is broken down into units, each associated with a year of past or future credited service.



MERCER

Human Resource Consulting

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November 12, 2002
Board of Investment Trustees
Montgomery County Government Retirement System

If all actuarial assumptions are met in the future and if there are no plan changes, the plan contribution as a percentage of the payroll covered by this plan is expected to increase. This is because the Optional Plans are closed to new non-public safety members; hence, the average age of active members is expected to increase in the future.

The July 1, 2002 actuarial valuation sets the County's contribution rates for the fiscal year ending June 30, 2004. The rates are set separately for public safety and non-public safety employee groups and will be applied to each group's total payroll for the fiscal year 2004. Thus, the exact dollar amount of the required contribution will not be known until the end of the fiscal year 2004. The contribution rates for fiscal year 2004 were determined based on the total payroll at July 1, 2002.

Investments

During the 2001-2002 plan year, the rate of return after investment expenses on fund assets was approximately -6.9%. On a market value basis, the return was \$271.9 million less than the 8% assumed rate of return. This \$271.9 million is phased in over a five-year period. Gains and losses from 2001-2002 and prior years produced a net loss on an actuarial-value-of-assets basis. As of July 1, 2002, net investment losses of \$358.6 million had not yet been recognized in the actuarial value of assets.

We used the financial information provided by the County without further audit.

Aetna Contract

The value of the Aetna non-participating group-annuity contract is excluded from all calculations. The 2002 valuation was based on an actuarial value of assets of \$2,036,100,709.

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Human Resource Consulting

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November 12, 2002

Board of Investment Trustees

Montgomery County Government Retirement System

Actuarial Assumptions

In order to quantify plan liabilities, a number of actuarial assumptions need to be set. There was no change in assumptions in this valuation. Below are key actuarial assumptions:

Investment Return Rate	8.0% per annum
Salary Increase	Age-based table with an average increase of about 5.5% per annum
Social Security Wage Base Increase	4.5% per annum
Consumer Price Index	4.0% per annum

The actuarial assumptions used in the current valuation are described in detail in Section VI of the report.

Participant Data

Between June 30, 2001 and June 30, 2002, there was a 1.2% increase in the number of plan members. However, the number of active members decreased by 0.7%, from 6,023 to 5,983. The total payroll increased by 4.6%, from \$318.7 million to \$333.4 million.

Aetna provided the retiree data, including benefits. The County provided data on active and terminated vested members. We reviewed the data for reasonableness and consistency, and we are not aware of any material biases due to imperfect data.

Supplementary Information

The July 1, 2002 actuarial valuation report also provides supplemental information, including the schedule of funding progress. This schedule is presented in the financial section of the County's Comprehensive Annual Financial Report. This information is intended to help users assess the System's funding status on a going-concern basis, assess progress made in accumulating assets to pay benefits when due, and to provide a means for making comparisons with other public employee retirement systems.

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Human Resource Consulting

Page 4

November 12, 2002

Board of Investment Trustees

Montgomery County Government Retirement System

The County extracted the information from the July 1, 2002 valuation report for the following schedules in the actuarial section and the statistical section of County's Comprehensive Annual Financial Report.

- Summary of Results
- System Contribution
- Actuarial Assumptions and Methods
- Solvency Test
- Schedule of Retired Members by Benefit Type
- Schedule of Actives

Actuarial Certification

All costs, liabilities, and other factors under the Plan were determined in accordance with generally accepted actuarial principles and procedures. The information provided has been determined in accordance with the provisions of Statement Numbers 25 and 27 of the Governmental Accounting Standards Board. The costs are calculated using an actuarial cost method that we believe is appropriate. The actuarial assumptions are reasonable in our opinion and represent our best estimate of the anticipated experience under the Plan.

The undersigned credentialed actuaries meet the Qualification Standards of the American Academy of Actuaries to render the actuarial opinion contained in this report.

Respectfully submitted,



Aquil Ahmed, ASA, EA



Douglas L. Rowe, FSA, EA

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ACTUARIAL SECTION

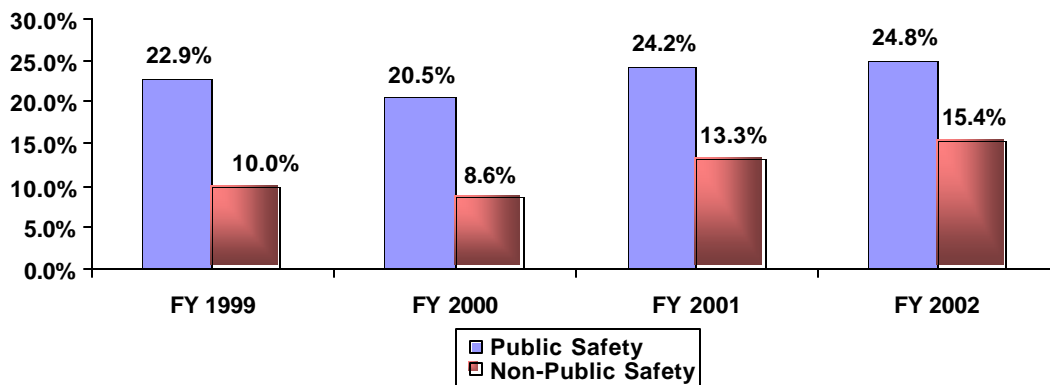
SUMMARY OF VALUATION RESULTS EMPLOYEES' RETIREMENT SYSTEM

A. Overview

This report presents the results of our June 30, 2002 actuarial valuation of the Montgomery County Employees' Retirement System.

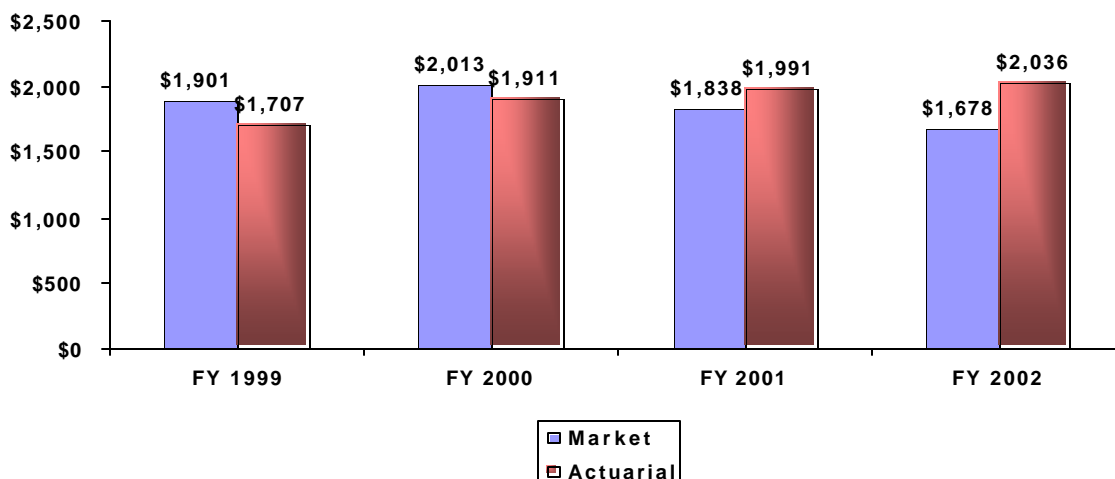
The major findings of the valuation are summarized in the following charts:

Employer Contribution Rates
(as % of payroll)



The majority of the increased rate of employer contribution in FY 2002 was due to increased plan benefits.

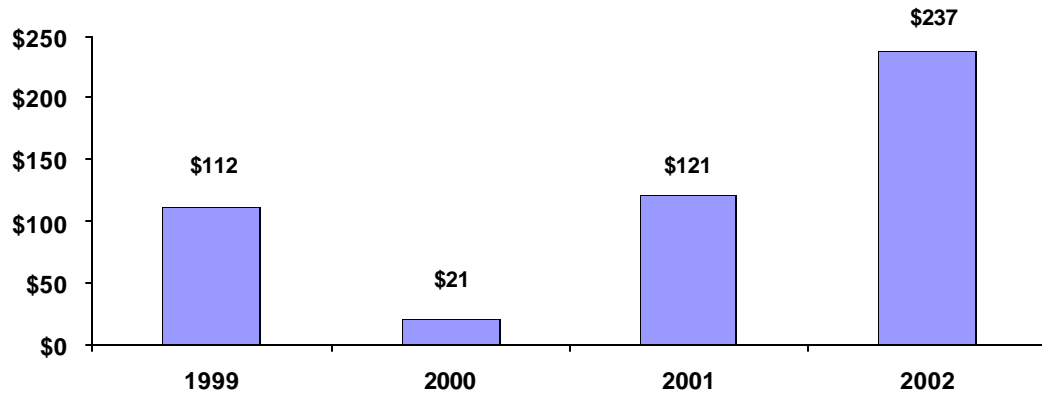
System Assets
(in millions)



ACTUARIAL SECTION

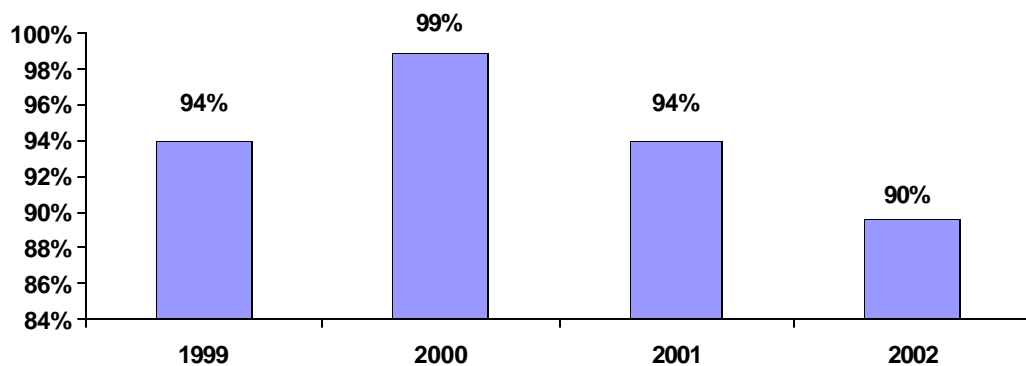
SUMMARY OF VALUATION RESULTS EMPLOYEES' RETIREMENT SYSTEM (Continued)

Unfunded Actuarial Liability By Valuation Year (In Millions)



The unfunded actuarial liability increased significantly in FY 2002 due to investment loss.

Funding Ratio



The ratio of actuarial assets to the actuarial accrued liability remained below 100% this year.

ACTUARIAL SECTION

SUMMARY OF VALUATION RESULTS EMPLOYEES' RETIREMENT SYSTEM

(Continued)

B. Summary of Results	July 1, 2001	July 1, 2002
Actuarial Liability		
a. Active Members	\$ 1,081,963,800	\$ 1,148,108,854
b. Retired Members and Beneficiaries	1,010,673,827	1,105,917,017
c. Vested Former Members	19,276,721	18,951,085
d. Members on Leave of Absence	32,105	202,260
e. Total	\$ 2,111,946,453	\$ 2,273,179,216
Valuation Assets	\$ 1,990,882,017	\$ 2,036,100,709
Unfunded Actuarial Liability	\$ 121,064,436	\$ 237,078,507
Normal Cost		
a. Gross Normal Cost	\$ 54,896,118	\$ 56,026,832
b. Anticipated Employee Contributions	14,051,053	\$ 14,606,389
c. County Normal Cost	\$ 40,845,065	\$ 41,420,443
Amortization Payment	\$ 14,698,336	\$ 23,647,310
Phase-In of Asset Method Change	\$ -	-
County Contribution at date shown	\$ 55,543,401	\$ 65,067,753
County FY 2003/FY 2004 Contribution (as a % of covered payroll)		
Public Safety Employee	24.24%	24.84%
Non-Public Safety Employees	13.33%	15.41%

SUMMARY OF VALUATION RESULTS EMPLOYEES' RETIREMENT SYSTEM

(Continued)

C. Valuation Highlights

1. System Assets

As of June 30, 2002, the System had assets, valued at market, of \$1.7 billion, as compared to \$1.8 billion at June 30, 2001. The decrease of \$160 million was attributable to the following:

- a. A increase of \$52 million from employer and employee contributions;
- b. A decrease of \$124 million from investment income; and,
- c. A decrease of \$88 million due to the payment of benefits to System participants.

When measured on an actuarial basis, System assets were \$2.0 billion at June 30, 2002, and \$2.0 billion at June 30, 2001. The asset valuation method smoothes the fluctuations generated by intermittent market gains and losses. This method phases-in investment gains and losses arising during and after the 1994 fiscal year over a five-year period from the date established. Effective July 1, 1997, the calculation of the actuarial value of assets was changed to exclude the present value of estimated accrued contributions.

2. System Liabilities

The Unfunded Actuarial Liability increased from \$121.1 million at July 1, 2001, to \$237.1 million at July 1, 2002. The changes in the Unfunded Actuarial Liability are shown below:

	Year Ending June 30, 2002
Actual Unfunded Liability at beginning of year	\$121,064,436
Actual Unfunded Liability at end of year	<u>237,078,507</u>
Increase in Actual Unfunded Liability	<u>\$(116,014,071)</u>

The increase in Actual Unfunded Liability for the year ended June 30, 2002, is comprised of the following:

Increase due to loss on actuarial value of assets	\$(76,656,381)
Decrease due to COLA gain	16,022,975
Increase due to demographic loss and other factors	(44,087,560)
Increase due to normal cost, interest and contributions	<u>(11,293,105)</u>
Increase in Actual Unfunded Liability	<u>\$(116,014,071)</u>

ACTUARIAL SECTION

SUMMARY OF VALUATION RESULTS EMPLOYEES' RETIREMENT SYSTEM

(Continued)

3. System Contributions

Contributions to the System include a "normal cost" rate which covers the portion of projected liabilities related to service of members. In addition, an amortization payment is made to fund the unfunded liability related to changes made to benefits in previous years which are being funded over a specific period of time.

The increase in the employer contribution rate is attributable to the following:

	Public Safety	Non-Public Safety
Employer contribution rate-June 30, 2001	24.24%	13.33%
Increase due to investment losses	1.06	1.43
Increase (decrease) due to actuarial gains & losses	(.24)	.95
Decrease due to gains from COLA	<u>(.22)</u>	<u>(.30)</u>
Employer contribution rate-June 30, 2002	24.84%	15.41%

4. Membership

The active membership of the System decreased from 6,024 at June 30, 2001 to 5,989 at June 30, 2002. The System was closed to all new employees hired after October 1, 1994, except public safety bargaining unit employees. Inactive members, including retirees and beneficiaries, increased from 3,989 at June 30, 2001 to 4,115 at June 30, 2002 and the number of former members with vested rights increased from 390 to 427.

SUMMARY OF ACTUARIAL ASSUMPTIONS AND METHODS EMPLOYEES' RETIREMENT SYSTEM

1. Funding Method

The funding method used for the System's valuation is the "projected unit credit" actuarial cost method. The objective of this method is to allocate the total pension benefit to which each participant is expected to become entitled at retirement to the participant's past and future service. The allocation is accomplished by applying the plan's accrual formula to projected final salary at retirement. An actuarial liability is calculated at the valuation date as the present value of benefits allocated to service prior to that date. The unfunded actuarial liability at the valuation date is the excess of the actuarial liability over the assets of the System.

2. Actuarial Value of Assets

For purposes of determining the County's contribution to the System we use an actuarial value of assets. The asset adjustment method dampens the volatility of asset values that could occur because of short term fluctuations in market conditions. Use of an asset smoothing method is consistent with the long term nature of the actuarial valuation process. Assets are valued at market value but with a phase-in of investment gains and losses arising after July 1, 1993, over a 5-year period. The gains and losses are net of expenses. Effective July 1, 1997, the calculation of the actuarial value of assets does not include the present value of accrued contributions.

ACTUARIAL SECTION

ACTUARIAL ASSUMPTIONS AND METHODS EMPLOYEES' RETIREMENT SYSTEM

(Continued)

1. Demographic Assumptions

a. Mortality

**1983 Group Annuity Mortality Table
Annual Deaths per 1,000 Members**

<u>Age</u>	<u>Male Deaths</u>	<u>Female Deaths</u>	<u>Age</u>	<u>Male Deaths</u>	<u>Female Deaths</u>
20	0	0	65	16	7
25	0	0	70	28	12
30	1	0	75	45	24
35	1	0	80	74	43
40	1	1	85	115	70
45	2	1	90	166	112
50	4	2	95	234	182
55	6	3	100	319	295
60	9	4	105	470	488

b. Termination of Employment (prior to retirement eligibility)

Annual Terminations per 1,000 Members

<u>Years of Service</u>	<u>Non-Public Safety</u>	<u>Public Safety</u>
0 - 4	75 - 72	80 - 32
5 - 9	70 - 42	29 - 19
10 - 14	35 - 20	15 - 7
15 - 19	18 - 12	6 - 4
20 - 25	11 - 7	3 - 2
26+	6	2

It is assumed that all participants who terminate with five or more years of service elect to receive a refund of their contributions with interest instead of a deferred benefit if they are less than age 41 when they terminate employment.

ACTUARIAL ASSUMPTIONS AND METHODS EMPLOYEES' RETIREMENT SYSTEM

(Continued)

c. Disability

Non-Public Safety Employees

Annual Disabilities Per 1,000 Members

<u>Age</u>	<u>Male</u>	<u>Female</u>
20	1	1
25	2	1
30	3	2
35	4	3
40	4	4
45	5	5
50	6	5
55	7	6
60	12	8
65	0	0

Public Safety Employees

Annual Disabilities Per 1,000 Members

<u>Male</u>	<u>Female</u>
2	1
4	2
9	6
11	9
14	13
27	25
45	39
55	41
68	42
0	0

d. Deaths

Annual Deaths Per 1,000 Disabled Members

<u>Age</u>	<u>Male</u>	<u>Female</u>
20	1	0
25	1	0
30	1	1
35	2	1
40	3	1
45	5	2
50	8	3
55	12	6
60	22	10
65	37	18

ACTUARIAL SECTION

ACTUARIAL ASSUMPTIONS AND METHODS EMPLOYEES' RETIREMENT SYSTEM

(Continued)

e. Retirement

<u>Age</u>	<u>Non-Public Safety Employees</u>	<u>Public Safety Employees Other than Group G</u>
41	0%	5%*
42	0%	5%*
43	0%	5%*
44	0%	5%*
45	1%	5%*
46	1%	15%*
47	1%	15%*
48	1%	15%*
49	1%	15%*
50	5%	15%*
51	5%	15%*
52	5%	50%
53	5%	50%
54	5%	50%
55	8%	100%
56	8%	100%
57	8%	100%
58	8%	100%
59	8%	100%
60	16%	100%
61	16%	100%
62	16%	100%
63	16%	100%
64	16%	100%
65	50%	100%
66	50%	100%
67	75%	100%
68+	100%	100%

*For Group G members, 30% at first eligibility for normal retirement if before age 52.

Note: Rates only apply when employee is eligible to retire based on age and service.

ACTUARIAL ASSUMPTIONS AND METHODS EMPLOYEES' RETIREMENT SYSTEM

(Continued)

f. Sick Leave Credit

Service credit is increased by 2.5% for members who receive their entire benefit from the County to account for additional credit from unused sick leave.

g. Assumption changes

In August 2000, the System's actuary, William M. Mercer, Inc., completed an experience study of the actuarial assumptions used for the five-year period ending June 30, 1999. All recommended assumptions were approved by management at that time.

ACTUARIAL SECTION

ACTUARIAL ASSUMPTIONS AND METHODS EMPLOYEES' RETIREMENT SYSTEM

(Continued)

2. Economic Assumptions

- a. **Investment Return:** 8.0% compound per annum
- b. **Cost-of-Living Increases:** 4.0% compound per annum
- c. **Increase in Social Security Wage Base:** 4.5% compound per annum
- d. **Salary Increase:** 4.0% compound per annum plus merit/promotional increase. Merit and promotional increases assumed to be based on age as shown below:

<u>Age</u>	<u>Merit/Promotional Increase</u>
22	4.1%
27	3.7%
32	3.0%
37	2.5%
42	1.4%
47	1.3%
52	1.1%
57	1.1%

ACTUARIAL SECTION

SUMMARY OF VALUATION RESULTS EMPLOYEES' RETIREMENT SYSTEM

(Continued)

ANALYSIS OF FINANCIAL EXPERIENCE

Gains and Loss in Accrued Liability During Years Ended June 30
Resulting from Differences Between Assumed Experience and Actual Experience

Type of Activity	1999	2000	2001	2002
Investment Income (or loss)	\$82,339,171	\$80,043,252	\$17,187,273	\$(76,656,381)
Combined Liability Experience	<u>77,705,772</u>	<u>7,238,096</u>	<u>(121,867,161)</u>	<u>(45,546,738)</u>
Gain (or Loss) During Year from				
Financial Experience	160,044,943	87,281,348	(104,679,888)	(122,203,119)
Non-Recurring Items	<u>(55,109,731)</u>	<u>(8,695,143)</u>	<u>121,889,595</u>	<u>-</u>
Composite Gain (or loss)				
During Year	<u>\$104,935,212</u>	<u>\$78,586,205</u>	<u>\$17,209,707</u>	<u>\$(122,203,119)</u>

SOLVENCY TEST

Aggregate Accrued Liabilities

Valuation	(1) Active Member	(2) Retirees Vested Terms, Beneficiaries	(3) Active Members (Employer Financed Portion)	Reported	Portion of Accrued Liabilities Covered by Reported Assets		
Date	Contributions			Assets	(1)	(2)	(3)
6/30/1996	\$103,408,028	\$861,735,357	\$565,205,715	\$1,186,771,118	100%	100%	39%
6/30/1997	112,106,701	871,615,938	598,843,034	1,317,475,134	100%	100%	56%
6/30/1998	121,197,443	899,019,607	639,816,988	1,496,651,390	100%	100%	74%
6/30/1999	124,544,357	943,551,243	750,895,023	1,707,450,187	100%	100%	85%
6/30/2000	136,181,427	1,014,314,792	781,418,094	1,911,114,401	100%	100%	97%
6/30/2001	143,356,036	1,029,982,653	938,607,764	1,990,882,017	100%	100%	87%
6/30/2002	146,500,545	1,125,070,362	1,001,608,309	2,036,100,709	100%	100%	76%

STATISTICAL SECTION

SCHEDULE OF ADDITIONS BY SOURCE AND DEDUCTIONS BY TYPE

ADDITIONS

<u>Fiscal Year</u>	<u>Plan Member Contributions</u>	<u>Employer Contributions</u>	<u>Employer Contributions % of Covered Payroll</u>	<u>Net Investment Income</u>	<u>Total Revenues/Losses</u>
1997	\$10,271,439	\$49,762,655	18.28%	\$241,044,722	\$301,078,816
1998	10,520,321	51,097,622	18.36%	270,973,304	332,591,247
1999	10,477,566	47,462,625	16.82%	165,709,869	223,650,060
2000	10,924,466	44,347,078	14.80%	135,337,568	190,609,112
2001	11,291,541	43,345,296	14.91%	(81,374,778)	(26,737,941)
2002	12,943,679	39,168,622	13.12%	(124,177,457)	(72,065,156)

DEDUCTIONS

<u>Fiscal Year</u>	<u>Benefit Payments</u>	<u>Refunds of Contributions</u>	<u>Administrative Expenses</u>	<u>Total Expenses</u>
1997	\$64,064,571	\$891,212	\$1,110,937	\$66,066,720
1998	67,655,746	1,058,325	1,177,356	69,891,427
1999	71,472,415	828,326	1,297,038	73,597,779
2000	76,387,491	860,699	1,219,552	78,467,742
2001	78,434,554	1,066,708	1,688,780	81,190,042
2002	85,322,387	681,375	2,092,364	88,096,126

STATISTICAL SECTION

SCHEDULE OF BENEFIT PAYMENTS BY TYPE

Fiscal Year Ended June 30	<u>Retiree</u>	<u>Disability</u>	<u>Survivor</u>	<u>Total</u>
1997	\$43,547,292	\$12,337,769	\$2,581,774	\$58,466,835
1998	46,448,135	12,939,482	2,840,404	62,228,021
1999	49,532,983	13,624,278	3,100,196	66,257,457
2000	53,463,287	14,716,815	3,188,218	71,368,320
2001	58,415,300	16,234,205	3,785,049	78,434,554
2002	64,030,235	17,250,631	4,041,521	85,322,387

SCHEDULE OF RETIRED MEMBERS BY BENEFIT TYPE

Fiscal Year Ended June 30	<u>Retiree</u>	<u>Disability</u>	<u>Survivor</u>	<u>Total</u>
1997	2,601	623	242	3,466
1998	2,675	648	262	3,585
1999	2,763	694	278	3,735
2000	2,831	734	304	3,869
2001	2,918	759	312	3,989
2002	3,002	783	330	4,115

SCHEDULE OF AVERAGE MONTHLY BENEFIT AMOUNTS

Fiscal Year Ended June 30	<u>Retiree</u>	<u>Disability</u>	<u>Survivor</u>	<u>Total</u>
1997	16,743	19,804	10,668	16,869
1998	17,364	19,968	10,841	17,358
1999	17,927	19,632	11,152	17,740
2000	18,885	20,050	10,488	18,446
2001	20,019	21,389	12,132	19,663
2002	21,329	22,031	12,247	20,734

STATISTICAL SECTION

SCHEDULE OF PARTICIPATING AGENCIES AND POLITICAL SUBDIVISIONS

Montgomery County Revenue Authority
Housing Opportunities Commission of Montgomery County
Town of Chevy Chase
Strathmore Hall Foundation, Inc.
Washington Suburban Transit Commission
Independent Fire/Rescue Corporations

Certain employees of the:
State Department of Assessments and Taxation
District Court of Maryland



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